The Economic Wars Between the States

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Abstract

Brazil's state governments–like many governments today around the world–view direct investment by large foreign and other "outsider" firms as opportunities for transforming their economies and the organizational culture of their own firms. This transformative view, as translated into a kind of "implicit industrial policy"–is richly reflected in the metaphors used by Brazilians to refer to the outsider firms–locomotives, anchor firms, leader firms and, even, mother firms. Policy advice proffered by international financial institutions backs this view, as do many governments themselves; for those who are interested, there is plenty of confirmation to be found in a large body of case-study research. The trouble is, however, that a growing body of case studies and cross-country reviews over the last decade also reveals that the evidence is now quite mixed: though outsider firms indeed have positive impacts in various instances, they definitely do *not* in others–and, in the worst cases, they may even have net destructive effects on local economies. Because the evidence is so mixed, the question I address here–and for which policymakers and program designers need help–is not whether or not outsider firms actually do work their magic on host regions. Rather, why does this happen in some cases and not others, and how could policy and program design help to elicit such positive outcomes? The paper attempts to throw some little light on the matter by drawing on interviews with various large firms, policymakers, and development professionals in Northeast Brazil–a lagging region of nine states and 40 million people–and on experiences outside the Northeast and Brazil, including the U.S. Southern states.

Explanations and acknowledgments

This paper is part of a larger project supported by a *convênio* between the Massachusetts Institute of Technology and the Bank of the Northeast. The purpose was to carry out and draw on a set of specific sectoral studies that could contribute to the debate about re-thinking regional policy–based on the experience of the last 20 years or so in these sectors (garments, footwear, textiles, irrigated fruit production for export). The project, starting in 1997 and headed by myself and my colleague Richard Locke, included research carried out by several M.I.T. doctoral students–for periods of up to three months at a time and, in the case of one doctoral dissertation, one year. These papers are listed in Annex I to this paper.

I am grateful to my colleague Richard Locke, and to the students whose papers are listed in Annex I, for entering into and participating so fully in what became a stimulating and engaged small community of true colleagues–the students are Rodrigo Serrano, Monica Pinhanez, Marcela Natalicchio, Nichola Lowe, Sylvia Dohnert, Octavio Damiani, Tito Bianchi, and Mansueto Almeida. Thanks also to Monica Amorim and Jose Oliveira. I am especially grateful for the luxury of having had Raquel Gomes as a research assistant on the bibliographic part of the paper.

All this would not have been possible without the generous support of the Bank of the Northeast (BN), and particularly ETENE within the BN–for both the remarkable logistical support and, more importantly, their interest in our research, the invaluable feedback on the papers listed in the annex, and the time they spent answering our questions and enlightening us about matters Northeastern. None of this would have come to pass, moreover, without the unstinting support and interest of Byron Queirós, President of the Bank of the Northeast, and Osmundo Rebouças, Director of the Bank of the Northeast The same can be said of the Department of Urban Studies and Planning at M.I.T. and particularly Bish Sanyal, Chair of the Department, for doing much more than making the project possible. His enthusiasm for this endeavor as an innovative way of combining teaching with research made the project an integral part of the curriculum at M.I.T. and, for this reason, in many ways more satisfying.

This paper draws in part on the papers thus far produced under the project and the discussions around them, as noted throughout the text, and on several interviews over the last two years in the states of Ceará, Pernambuco, Rio Grande do Norte, and Paraíba. The interviews were conducted with owners and department directors of firms mainly in the garment, footwear, and textile industry, in addition to the growers of melon in Rio Grande do Norte, as well as with firm associations–and also with staff and officials of the Bank of the Northeast and of the state governments of Ceará, Pernambuco, and Rio Grande do Norte. Some elected officials, input suppliers, and staff of state labor offices were also interviewed, as well as academics working on this subject matter. Particularly helpful were meetings at which feedback on the papers was given at ETENE in Fortaleza and at the Economics Department of the Federal University of Pernambuco in Recife.

This paper does not summarize the findings of the project papers, though it draws substantially on some of them as a basis for setting forth certain views and findings about this topic. Partly to draw attention to the rich studies produced by the student researchers, and partly to give credit where credit is due, I have noted throughout where the interpretations come from these papers, rather than myself. Needless to say, some of my interpretations may not necessarily be shared by all members of the group, nor by the institutions that supported the project.

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The Economic Wars Between the States

Today, many countries around the world compete with each other to attract large outside firms, offering all manner of subsidies and upping the ante, as in an auction, when their competitors seem to be making more attractive offers. In federalist countries like Brazil or the United States, this competition takes place at the level of state government and, often, municipal government. In both countries, the metaphor of "war" is used to name these competitive attempts to recruit firms from outside–"the economic wars between the states" in the United States, and "the fiscal wars" (*Guerras Fiscais*) in Brazil.[1] Based on the long U.S. experience with this competition, starting in the first quarter of the 20th century, an extensive literature on this subject has arisen–mostly critical--by specialists in public finance, local economic development, industrial location, regional science, and economic history. In Brazil, the Wars are a more recent phenomenon, and the subject has come under this serious research scrutiny only more recently, in the last decade.[2] In what follows, I refer to this set of policies as *Guerras Fiscais* (GFs), or the Wars, or, following the U.S. literature, "recruitment" policies and

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[1]I have translated the Brazilian term *Guerras Fiscais* into "economic" rather than the more literal "fiscal" wars, partly because it is the adjective used to describe the phenomenon in the U.S., and partly to portray the broader array of instruments than the English word "fiscal" conveys. Goss & Phillips, for example, refer to "the economic war between the states" (1999:217)–and also to an earlier critique published by the Federal Reserve Bank, entitled, "Congress should end the economic war among the states" (Burstein & Rolnick 1995).

[2]For example, Affonso, Rui de Britto Álvares (1995, 1997); Afonso, José Roberto Rodrigues (1994, 1995); Afonso, José Roberto Rodrigues, Júlio César Maciel Ramundo, and Erika Amorim Araujo (1998); Lagemann, Eugênio (1995); Cavalcanti, Carlos Eduardo G., and Sérgio Prado (1998); Varsano, Ricardo (1997); Hillbrecht, Ronald (1997); Arbix (2000); Arbix, Glauco, and Andrés Rodrígues-Pose (1999). (I thank Al Montero for generously leading me to some of these works.) Two opposing views on the *Guerras Fiscais* were also published in July 2000 in the Ceará newspaper, *O Povo*, on the occasion of the *Foro* sponsored in Fortaleza by the Bank of the Northeast. The FGV/RJ economist Pedro Cavalvanti took a position against, and the Brazilianist and University-of-Illinois economist Werner Baer took a position in favor; these views were reported in separate interviews at the end of July (www.opovo.com.br).

incentives.

With some important exceptions, most economists are critical of the recruitment subsidies to outside firms.[3] Many elected officials, and some economic-development practitioners, like them.[4] The large donor institutions emit a mixed message: though their public-finance specialists may criticize the recruitment subsidies roundly, other parts of them are strongly in favor, if only implicitly so–as seen in their strong support for improving the "enabling environment" that supports direct foreign investment, and their emphasis on the importance of the transformative impact of large, outsider firms on the local economy. Governors and their recruiters say the outside firms provide immediate relief for problems of unemployment. They herald the outsiders as bringing new production technologies and organizational cultures, mentoring large and sophisticated customer firms for locally-supplied inputs and services, and contacts to export markets. At the least, as one governor said in response to criticisms of the recruitment policies, the newly recruited firms are "much better than nothing" as a policy to

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[3]There are some exceptions. The economist Jeffrey Sachs has on various occasions taken a strong stand in favor of recruitment subsidies by countries as a strong tool of economic development in an age of global trade. If anything, he thinks that countries should offer more, not less, and cites Costa Rica's recruitment of Intel as a felicitous example. With respect to Brazil, Montero (2000) reviews arguments by Affonso (1997:18) (see previous note) that the tax losses foregone are exaggerated, and that some state governments, indeed, have been spurred by these losses to increase tax collections in other ways, introducing important fiscal reforms. Another exception is Werner Baer, who argued in favor of the *Guerras Fiscais* as an instrument of industrial policy in the interview cited in the previous note.

[4]Subsidies typically include, among other things, exemption from the value-added tax (ICMS), which is collected by states, for a period of roughly 10 years and often renewable (since such exemption is technically illegal, this subsidy officially works as a "loan" by the state government on highly subsidized terms for up to 75% of the value of the tax); access to investment credit at favorable rates at official banks; public investments in firm-specific infrastructure, as well as more general infrastructure; reduced rates for electric power, telecommunications, and water. Vasconcelos et al (2/1999:13, 28, 29) provide data and other material on the concessions provided by the state of Ceará, which are roughly similar to those of other states. An extensive list of the concessions listed in recent protocols between state governments and multinational auto-assembly firms--though outside the Northeast–can be found in Arbix (2000).

reduce unemployment.

Many economists and other critics of the GFs typically argue that the subsidies are an unnecessary expenditure of scarce public resources, because studies frequently show that outside firms make decisions to move to a particular state or region for other reasons–raw-materials supply, infrastructure, qualities of the workforce, and proximity to suppliers and to markets.[5] In face of this evidence, they attribute the puzzling persistence of recruitment subsidies to two factors. One is the political "yield" of these policies to presidents, governors, or mayors, as discussed further below. The other is the result of a collective-action problem: if states got together and agreed not to offer such subsidies, or if the federal government successfully prohibited this behavior (both highly unlikely), this would do much to solve the problem without jeopardizing the interest of outside firms in locating in the region.

Critics of recruitment policies also consider them to be a "race to the bottom," particularly to the extent that they sell their comparative advantage to outside firms as being cheap-labor and labor-unfriendly policies. This is a tactic to which poor regions in particular seemed doomed, like the Brazilian Northeast and the U.S. South, since the very nature of their relative backwardness means that labor costs will always be considerably less than in the richer part of the country. This particular critique of recruitment policies has gained more salience today, because of the new emphasis on improving quality rather than only reducing cost, and on

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[5]Doeringer and Terkla, for example, report a general consensus that "business incentives more often than not are only marginally effective" in determining differences in growth differences between regions or states, and that the effect of taxes is "mixed." Their own econometric work on the state of Massachusetts shows that "traditional tax breaks and business subsidies may have little effect on local growth patterns"–a "disquieting finding for development policies that rely on cost subsidies to attract jobs" (1990:487-88). Cobb (1993:57-58), in writing on the Economic Wars of the U.S. South, similarly reports a consensus among U.S. economists and industrial-location

a more literate and skilled labor force in order for countries or regions to become more competitive in this era of globalized trade, information technology, and industrial re-structuring.

The Brazilian federal government has been critical of the states' recruitment policies for the same reasons, in addition to a larger concern that the autonomy of state governors, together with their control over state banks and their ability therein to undermine central-bank regulations, creates a "major threat to stabilization."[6] Exacerbating this situation, in this view, the recently acquired right of state governments to set different rates for the value-added tax on goods and services (ICMS), which accounts for one third of Brazil's tax revenue, provides one more fiscally-distorting weapon in the arsenal of the states to recruit outside firms by competing with other states. (Exemptions from the ICMS tax–typically for 10 years or more and often renewable--are a central feature of the recruitment package.)

Because of the by-now widely disseminated debate on these issues in Brazil, together with the longer U.S. literature, not much can be gained here by elaborating on the arguments pro and con. Though my own position on the argument at the start of our research was more against than in favor, I was nevertheless intrigued with the challenge of finding a few positive sides to the *Guerras Fiscais*, given the weight of the opinion and the evidence against them among colleagues and friends. Just as important, there seems to be little sign that the GFs will abate. It is therefore important to come up with some constructive suggestions within that set of constraints--as to how they might be improved to serve the purpose of economic development

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experts that the recruitment subsidies did not make a difference in the location decisions of firms, a skepticism that also tended to be confirmed by surveys of the executives of the recruited firms.

[6]Melo (2000:14-15). The page numbers cited are from an earlier draft of September 1998. Melo also cites Sola (1995) on this matter. The following sentence in the text is also drawn from Melo.

better, and how the Bank of the Northeast might be particularly suited to play a facilitating role in such an endeavor.

This paper, then, notes some positive aspects of the *Guerras Fiscais,* along with some negative aspects that should receive more attention, and also makes some suggestions about how recruitment policies might be modified to better effect. Section I reviews the relevance of the U.S. Southern experience to the GFs in Brazil today. Section II notes some positive aspects of the GFs, and suggests how these opportunities might be exploited. Section III treats the issue of the bargaining power of the states–typically seen as low–in negotiating with outside firms. Section IV concludes, and makes some suggestions for a role to be played by the Bank of the Northeast.

I - Lessons of the U.S. Southern experience

Some of the positive aspects or opportunities of the *Guerras Fiscais* can best be perceived against the backdrop of the experience of the U.S. South, which started its own Economic Wars in the 1920s, many decades before the Northeast Brazilian states did. The similarities between the U.S. South and the Brazilian Northeast as lagging regions, and particularly with respect to the Economic Wars, are remarkable. In both regions, the metaphor of war has been used to describe the competition between the states to recruit outside firms.

In both regions, the onset of the Economic Wars related partly to reduced employment resulting from a declining and often stagnant agriculture. In both cases, they promoted the location of manufacturing plants in rural areas with no industrial experience and an unskilled labor force that had worked only in farming (for the U.S., Cobb [1993:100]). Both regions construed one of their major comparative advantages to be a cheap and docile labor force. In both cases, states assisted the newly recruited firms to reduce workers' real wages, more indirectly in the Brazilian case than in the U.S. case.[7] The states of both regions also banked the cost of firm-specific and shopfloor training for numerous new and inexperienced workers hired

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[7]In the 1930s, the U.S. Southern states mandated that employers deduct 5-7% from worker wages in the name of promoting the state's economic development. These deductions went into a fund used by the state to offer subsidies to the recruited firms for the cost of building a plant or other related investment subsidies (at that time, the prevailing wage in these industries was US$5.55 per week)(Cobb 1982:5ff). Though there is no such direct financing deducted from workers' wages in the Northeast, there is a similar indirect mechanism that reduces workers' real incomes by relieving firms of the obligation of paying fringe benefits. Namely, state governments have encouraged and assisted recruited firms to decentralize production to newly formed "labor cooperatives," which have the status of contractors rather than employees of the firm. Though the responsibility of paying fringe benefits now rests with the "cooperative," many of these associations--newly formed with the assistance of the state government and the firm--operate as outposts of the firm itself, and do not function as true cooperatives, let alone pay fringe benefits.

by the newly-recruited firms.[8] In both regions, the Wars provoked outcries from established local firms for whom such lavish subsidies were not available.[9]

The Economic Wars also provoked the consternation of the federal government in both countries, on the grounds that the incentives compromised federal tax revenues. In both cases, some aspects of the recruitment subsidies were expressly prohibited by law, and state governments either ignored these prohibitions or structured their tax exemptions and other financing provisions so as to circumvent them.[10] In both regions, state governments defended themselves against their critics with the same argument that there would have been no tax revenues to forfeit if firms had not been recruited to the state in the first place (Cobb 1993:50 for the U.S. case). In both cases, states in the richer part of each country--after witnessing the erosion of their industrial base by the poorer region's "raiding"--counter-reacted. First complaining bitterly, they then initiated their own version of the poorer-region's recruitment programs. Both regions, finally, perceived themselves as having been long subject to policies of "internal domination" and other unfairnesses inflicted upon them by the more developed part of the country. Needless to say, there was a certain sweet revenge in their ability

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[8]In the late 1930s, the state of Georgia paid "training wages" to future employees being trained on the recruited firm's shopfloor or a school operated by it. This is remarkably similar to the "training scholarships" supplied by Ceará and some other state governments to the future workers of its recruited firms, as described elsewhere.

[9]See Cobb (1993:40) for the U.S. case. When agriculture was more important in the U.S. Southern economy, local agricultural elites protested the recruitment policies because they would draw labor out of agriculture. Later, in North Carolina, local textile and tobacco firms pressured to get the same incentives as those offered to outside firms (Lowe 1999).

[10]In the U.S. case, the use of state revenues for industrial promotion was illegal. The subsidies paid to the outside firms were originally financed out of federal tax-exempt bonds, which had implications for federal monetary policy; firms could also deduct their amortization payments on the bonds from their corporate income taxes as operating expenses, which reduced federal tax revenues accordingly. In the Brazilian Northeast, some states get around the illegality of waiving the value-added tax by "lending" the tax owing to the firm, and on highly subsidized terms.

to raid the industrial base of certain important sectors in the richer region, which always viewed them as inferior.

Because the U.S. South started its Economic Wars many years before Northeast Brazil, several of the policy approaches and even justifications found in Northeast Brazil today are remarkably similar to policies and arguments of the U.S. states of 30 or 40 years earlier. This time lag is the main *difference* between the two cases. It is what makes the comparison to the U.S. case of particular value: some of the U.S. states have learned hard lessons from this experience, and moved beyond the original forms of the Economic Wars that prevail today in the Brazilian Northeast.

In some states of the U.S. South, the long experience with recruiting outside firms turned into a focal point for state government to develop grounded strategic thinking and iterative learning about the *local* economy, as well as about how to link outside firms to it. In others, it did not. I draw on some of these more positive lessons from this mixed experience as a backdrop for the discussion of the Northeast recruitment programs and how they might be improved. Much of what follows draws on Cobb (1993) and the research by Lowe (1999) done for this project on the state of Mississippi and some other states.

In the last third of the 20th century, many states in the U.S. South lost outsider manufacturing plants to other countries or states–plants that they had previously courted assiduously and subsidized lavishly. These plant closings often left in their wake a large number of jobless and little in terms of local economic development that could survive the departure of a major employer. In several states, including Mississippi–one of the persistently poorest Southern states–many state planners and policy analysts blamed their longstanding economic woes and poverty on what they came to call "smokestack chasing" and, later, a "low-road strategy" to recruiting outside firms. Namely, the states used public funds to subsidize land, credit, and tax exemptions, assured the recruited firms of lax reinforcement of environmental and labor standards, and also promoted the state's cheap labor as their comparative advantage, along with an explicitly unfriendly environment for worker organizing.

In retrospect, many state economic-development officials and technicians came to believe that this set of policies had caused the state to attract a disproportionate number of footloose, "fly-by-night" branch plants, particularly the cut-and-sew branch of the garment industry. Correspondingly, because the state had provided little support to existing local firms or to facilitating linkages between them and the outsider firms, these commentators came to believe that they had simply "pampered and protected" a set of outside firms that had had no industrial or institutional base in the state (Lowe, p. 33). Looking around for models of better experiences in other states, Mississippi officials and technicians contrasted their own policies with those of North Carolina and Georgia. These states had taken another tack as early as the 1950s. Instead of recruiting "flyaway" branch plants, for example, they shifted emphasis to bidding for the re-location of corporate headquarters. They also became more interested in higher-technology and more skill-intensive industries (Lowe, p.5).

Reacting to their disappointing experience, the planners of economic development in Mississippi and other states re-focused their attention on upgrading existing industries in the state. In this spirit, they decided to expressly exclude from their recruitment efforts those outside firms in sectors with low barrier to entry. It was the low entry costs, including the reliance on unskilled labor, that made it easier for firms to pick up and re-locate at a moment's notice and without much loss, as soon as another lower-cost site appeared elsewhere. This position has come to be increasingly held by experts on recruitment policies in the U.S. states–namely, that certain kinds of incentives that attract footloose firms are to be avoided in general (Mortimer & Peres 1998). In Northeast Brazil, firms in low-entry-cost sectors are frequently the kind that state governments work hard to recruit, particularly in garments and footwear.

Based on the learning from past mistakes, the U.S. states of North Carolina and Arkansas introduced programs to encourage competitiveness in their own "traditional" industries--textiles, food processing, or timber–including the introduction of new high-technology processes; they also worked to upgrade workforce skills in these industries (GG 19XX:79). Until then, state development officials had looked down on these local industries as "already mature," traditional, or backward, and had searched instead for more "modern" and "high-tech" plants to recruit from outside the state. This earlier attitude toward traditional industry is similar to the current dismissiveness we encountered among many Northeast state government officials toward "traditional" industry within their borders, and to the desire to reduce the cost of labor even further by facilitating the access of the new recruited firms to labor with *less* skills.

In Mississippi, state planners found that economic growth turned out to be greater in the northeast corner of the state, where "traditional" industries were concentrated and assisted locally. This contrasted with the higher-tech plants recruited from outside and scattered throughout the state, which never subsequently generated a sustained process of development (Lowe 1999:10-11). After a process of assessing the "upgradability" of the "traditional" industries in the northeast quadrant--like furniture and furniture fixtures–the state government instituted supportive programs and targeted outside firms that would complement this effort. This successful initiative was followed by growth in health-care services and wholesale marketing services. One particular county in northeast Mississippi (Lee County) now targets only those outside firms that best complement its existing industrial mix.

Mississippi officials also spoke critically of how, before the 1970s, they had relied so much on the opinions of outside experts–both with respect to specific recruitment efforts and in terms of broader economic development strategy. This, they felt, had also contributed to the state's problems of slow development, and they subsequently tried to also look inward, to expertise that could help build on past experiences and connect recruitment policy more integrally to the local economy. To this end, Lee County in Mississippi formed a recruitment committee composed of public agencies, nonprofit organizations, banks, and other firms and their associations to assess which firms from outside would be the best fit for the local economy (Lowe, pp. 36-39). Mississippi had actually relied on a similar kind of mechanism earlier, during the so-called BAWI program (Balance Agriculture With Industry) of the 1930s. The state drew on local and regional intermediaries–public utilities, railroads, banks, and local development agencies--to evaluate the soundness of prospective bidders for its recruitment subsidies (Lowe, p. 23). Also contributing to this broader pool of experts were supra-state regional institutions like the Tennessee Valley Authority, and the Appalachian Regional Commission (Lowe, p. 36).[11] In the Northeast, the Bank of the Northeast clearly has this same

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[11]Even starting in the 1920s and 1930s, the U.S. Southern recruitment efforts were more subject to broader approval in that the subsidies were financed by public bonds that had to be put to public vote–a "referendum"–in each case (Cobb 1982:16ff). Even to put such a proposal up for referendum, 20% of the citizens had to present a petition. These requirements elicited some sort of airing of the issues around recruitment programs, though the fact that a

kind of stature and expertise *vis-à-vis* the states.

After the 1970s, those concerned with Mississippi's economic development viewed this wider involvement of actors and experts in the local economy as leading to the formation of broad and helpful pro-development coalitions both inside and outside the state. These helped, among other things, to protect the recruitment process from the whims of elected officials, or imprudent or venal decisions with respect to the benefits of subsidizing the recruitment of a particular firm (Lowe, p. 41). Toward this same end, the state government separated out–and into different offices–the day-to-day implementation of recruitment policies (advertising, lobbying outside the state, etc.) from strategic planning around recruitment and state development, including research (Lowe, pp. 23, 29, 41).

In the recruitment efforts of the states of Northeast Brazil today, a few signs of such a more strategic approach to recruitment are appearing. I present them later below, as they belong after the earlier parts of the following section.

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majority of the population was disenfranchised from voting on the grounds of race and literacy substantially diminished, obviously, the breadth of this outside involvement.

II - What's good about the Guerras Fiscais?

My positive observations about the *Guerras Fiscais* fall into three categories, corresponding to the following subsections: (1) the quality of state-government administration; (2) the political "returns" generated by successful recruitment for governors and similar actors; (3) reflections on certain Northeast examples of movement along the path from the narrow (catching an outside firm) to the broader (local economic development); and (4) some lessons from Northeast recruitment initiatives from an earlier period.

It is with some trepidation that I try to place a positive spin on the experience of the Northeast states with their *Guerras Fiscais*. Many states, after all, will not take the opportunity to learn from the mistakes of the recruitment experience, or to link recruitment to wider developmental effects. These reservations expressed, it still appears that the recruitment experience–properly shepherded–may have certain advantages as an entry point into dealing with broader issues of economic development, as compared to a set of more abstract do's and don't's about industrial policy. It is more grounded in the particulars of each state, and it is fueled by the excitement and sense of accomplishment, each time a "big fish" is landed.

A. Competition and state reform

At their best, the *Guerras Fiscais* may actually contribute toward improving the quality of a state's administration, including its strategic thinking about development policy and its capacity to be proactive in this area. This relates not only to the state departments of industry and commerce typically responsible for economic-development policy, but to other areas as well–like administration of tax collection, infrastructure planning, etc.[12] Ceará is one of the obvious leaders in this area, notwithstanding the fact that there are also elements to be criticized in its recruitment policies. More generally, as Affonso has pointed out, some state governments have actually been spurred by the problem of foregone taxes to increase tax-collection efforts in other areas, sometimes introducing important fiscal reforms.[13]

The dynamic that drives this improvement often involves a sense of competition between the states–a variation on the same competition for which the *Guerras Fiscais* are criticized. Some of the Northeast state governments, for example, expressed a certain shame at having been left behind by Ceará's forward surge in recruiting firms from outside, as well as its economic growth. They were at the same time inspired by this example, and wanted to imitate it. In prior research on the history of reforms of public administration in Northeast Brazil, I often found this kind of competitive dynamic between states (or *municípios*, cities, and even towns) to have played an important role in stimulating improvement and adoption of innovative programs. The mechanism is simple: when public officials and technicians hear of a successful reform in a neighboring state (or city), they often think–"if *they* could do it, so could we!"--or, in a more confident variation on this reaction, "we can probably do it even better than they have, because we're *better*."

The dynamic I am describing, at the same time, is not simply about market-like competition between governments–one of the common arguments in favor of more

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[12]I thank the public-finance economist, Remy Prud'homme, for a conversation about the Brazil fieldwork that set me thinking in this direction.

[13]Affonso (1997:18), as cited by Montero (2000).

decentralized fiscal policies. It is also stirred by local pride, strong identification with place, and stereotypes about how people in one place are better than those in other places. Successful reform initiatives have often appealed to and thrived on these strong feelings of local pride, and of superiority or inferiority toward other regions, states, or towns.

This combination of inspiration and shaming seems to have contributed strongly, for example, to Pernambuco's reaction to being left behind in economic growth by Ceará, including the latter state's success in attracting firms from the outside. Pernambuco now seems to be turning more active and "serious" in its economic-development planning, after a long period of criticism–from both inside and outside the state–for its lack of initiative in this area. In a different example, the competitive desire to prove oneself better than other states certainly contributed to the successful fiscal reform in Ceará, initiated in 1987 and leading to, among other accomplishments, significant increases in the valued-added taxes collected by state tax inspectors. Agency managers imbued their tax inspectors, as reported by these civil servants themselves, with the idea that their improved collection efforts would directly advance the state's economic mission of pulling ahead of the other Northeastern states (Bonfim 1999).

Critics of the *Guerras Fiscais* suggest uniform measures, regulations, and taxes as a way around the problem of states trying to outbid each for firms that are interested in locating in the region anyway. In general, such uniform measures are often preferable for various reasons, including fairness and consistency, let alone matters of macro fiscal management. Though a uniform set of Northeast-wide (or Brazil-wide) recruitment policies might be an ideal or first-best solution to the problem of the *Guerras Fiscais*, it would at the same time also exclude this particular dynamic of local pride and competitiveness, and the imitative enthusiasm that it sets in motion.

"Confiabilidade" **vs.** ***subsidies***. That successful recruitment efforts might reflect more general improvements in a state government's administration–and not simply the nature and value of the subsidies offered to candidates–is consistent with comments we sometimes heard from firm executives, and with the results of some surveys.

In our conversations with executives about their reasons for locating in a particular state, they often alluded to the degree of "*confiabilidade*" of the state government. (Not surprisingly, Ceará scored high on this measure.) They also said that the package of subsidies and other incentives offered by state governments influenced their location decisions less, especially given that "all the states offered roughly the same subsidies anyway." When asked what they meant by *confiabilidade*, they spoke of the confidence they had that state government would come through with its commitments. This was judged partly by various seemingly trivial signs of reliability in the initial moments of the recruiting process itself–being met at the airport, having immediate access to the governor, having phone calls returned, not having to wait for appointments.[14]

Confiabilidade may seem indistinguishable from the incentives themselves. After all, a firm's confidence relates to whether the promised subsidies and public investments will actually be delivered. But there is still a distinct difference: firms were not only concerned that the state governments come through on their formal commitments, but also that they (the firms) could

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[14]Results of a survey of 25 firms recruited to Ceará are not inconsistent with these impressions, though they do not rank *confiabilidade* higher than the incentives themselves. *Confiabilidade* ranks among the five highest of ten reasons mentioned by manufacturing firms for choice of that particular state (ranked fourth by 27%), though not as high as the recruitment subsidies (ranked first by 40%), and cheap labor (ranked second by 27%) (Vasconcelos et al

count on a sustained institutional environment subsequently in which future problems that might come up could be resolved.[15] In this sense, the decisions of outside firms to locate in a state represent less a response to the government that offers the best deal for that particular firm, as they do the recognition of a sustained quality of reliability and competence in state government, which can not necessarily be turned on only for particular deals.

1999:38). (The survey actually phrases this factor as "*perspectiva de continuidade administrativa*," rather than *confiabilidide*.)

[15]Reporting on factors influencing different employment growth rates between states and between counties within the United States, Doeringer and Terkla (1990 and 1992) argue that these and other such "invisible" factors are much more important in influencing firm decisions on re-location than "visible" cost factors like taxes, energy costs, and wage rates. Included among these factors were constructive and progressive labor relations, the ability of the local economic development agency to analyze the match between the company-specific needs and the invisible strengths of the region, the degree of civic organization provided by business and government leaders at the local level, and the willingness and ability of local government to accommodate "to unanticipated problems that might arise in the future." (The quotation is from 1992:264-265). With respect to Japanese auto firms looking for places to locate in the U.S. South, for example, their interviews revealed a concern that the community selected by the firm have the civic institutions that could later help assimilate the new firm into the community, establish working relationships between schools and employers, and enhance the local race relations climate" (1992:270). (It should be noted that the concerns of Japanese companies were somewhat different from those of U.S. companies re-locating.) Doeringer and Terkla call these factors "invisible strengths" and give this name to their book (1987). This is somewhat akin to what the international donor community now calls "the enabling environment," though more apt because it conveys the overshadowing of these invisible strengths in recruitment strategies by the mistaken exclusive emphasis on "visible" factors that can reduce costs.

B. Politics over economics

Judging by the 80-year history of the U.S. Economic Wars, the Brazilian *Guerras Fiscais* may be around for quite some time to come–regardless of the persuasiveness of the arguments against them--if only because of their political *cachet*. They have come to be seen as a sign of high activity by governors and their economic-development teams, and they produce quick, visible, and countable results: a new modern factory (or the announcement of its imminent arrival), and a specific number of promised new jobs, indirect as well as direct.[16] That the new firms might leave some years later–as with the footwear firms of Alpargatas in Pernambuco, and Azaléia and Brochier in Paraíba–will be of no consequence to the government that brought the firm in the first place, since it will likely be out of power by that time.

The perceived political "yield" of the recruitment policies makes it difficult to convince officials to abandon this approach, simply on the grounds of economic logic, research results, or projected possible future loss to the economy that will occur when a particular governor has long since left office. By the same token, however, the repeated public announcement of recruitment victories and the political salience that the policy acquires, also create an opportunity: they can make state governments more politically vulnerable to findings that show a more mixed picture, and for this reason may compel them to be constructively responsive to such critical findings. The strong public criticism of Ceará's policy of encouraging and financing the decentralization

[16]A study of the effects of recruitment incentives in the United States published recently in the *American Economic Review* (X, 1996) raised the question as to why recruitment programs are so popular, despite the fact that several economic studies–reviewed in the article--show that they make little difference in influencing firms' location decisions. Their answer was political: the subsidies, and the "landing" of a large firm, made the mayor or governor of the moment seem highly proactive and successful in voters' eyes. (The authors' own field inquiries and regression analyses, while confirming the findings of the literature, found nevertheless that the incentives did had some effect, but only at one end of the spectrum of differences in tax treatment between states.)

of production in recruited firms to newly-formed “labor cooperatives” is an example. Under this fire, the state ultimately withdrew its official support from this policy, which had been so central to the recruitment strategy.

Making the political appeal of the recruitment policies work toward positive rather than negative ends might also be served by separating out, organizationally, the day-to-day lobbying and other implementation activities around recruitment from the vetting of proposed firms, analyzing the results of past experience, and suggesting modifications in the policies. This was one of the aforementioned lessons learned and successfully acted upon by the U.S. Southern states, in trying to keep promotional enthusiasm and political meddling from clouding the perceptions of which recruitments, and with what conditions and supports, would best for the state.

C. Ceará and Pernambuco reflections

In the recruitment efforts of Northeast Brazil's states, one sees some signs of a more strategic approach to recruitment that tries to build on existing local firms. Some aspects of Ceará's recruitment of outside firms are an example. The state aggressively and successfully campaigned to recruit the world's largest zipper manufacturer, YKK, to locate in Fortaleza, because of the large number of small and medium garment firms producing jeans locally, and because of a previous recruitment success some years earlier of another key large producer in the jeans supply chain–the denim-producing firm, Vicunha (Dohnert 1999). YKK subsequently played an important role in providing technical assistance to local jeans manufacturers, in accordance with the best image of the impact of outsider firms and the programs that recruited them.

Similarly, at the time of our research, Ceará was trying to recruit one of the two large buyers of shoes for export located in Southern Brazil. Whether or not the attempt was successful, the thinking was again strategic with respect to local manufacturing capacity: the state government calculated that recruiting such a large export buyer would not only have a major impact on opening up export markets for the state's footwear industry, but it would also stimulate outside footwear firms to re-locate to the state, following in the footsteps of the buyer. Also like some of the U.S. Southern states, Ceará is now trying to create a semi-autonomous economic "think tank," which would be independent of the day-to-day running of the recruitment and other implementation matters.

The Ceará recruitment experience is recent enough that it has not yet lost a major outside firm.[17] Unlike Ceará, Pernambuco has already lost some firms it had previously recruited in a much earlier period. Reeling from that experience, some state development officials and politicians became leery of recruitment policy, similar to the concerns of the U.S. southern states. One usually hears unflattering interpretations of this wariness, however, as representing incompetence on the part of Pernambuco's government or its governor. Though there is certainly some truth to this portrayal, this period may nevertheless also turn out later, in retrospect, to have been a time during which the state was also digesting this loss and re-thinking its approach–à la the U.S. Southern states.

One of Pernambuco's stated reasons for its recent lack of enthusiasm for recruitment of outside firms, according to officials, had been the previous governor's skepticism about spending public monies on outside firms "instead of on health and education." Although Pernambuco may not have done significantly better in these latter areas, it is also true that placing a high priority for public expenditures to health and education is certainly a view that shares good company today. In that Pernambuco is at a later stage of its industrialization than Ceará, moreover, it is less able to compete with the cheap-labor or anti-union credentials that less industrialized states like Ceará can. Indeed, part of Pernambuco's recent economic growth has been fueled by new *service* industries–particularly, software and private medical clinics–that require a more literate labor force than the footloose industries moving to Ceará today. If one wanted to view the

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[17]Ceará's recent period of aggressive recruitment started in the late 1980s, and started to produce substantial cumulative results in the early to mid-1990s. For most of the recruited firms, then, the ten-year tax-exemption period has not yet expired, though its imminence has been cause for recent concern and strategizing by the state government about what to do. It should be pointed out, moreover, that though the *Guerras Fiscais* are recent in their present form, many of the states engaged in aggressive recruitment of outside firms previously. In that period, they relied for financing mainly on the regional Northeast venture-capital and credit subsidies (34/18, then FINOR)

Pernambuco story through a more sympathetic lens, then, these particular facts would contribute importantly to an explanation of the state's "failure" to recruit outside firms at the same rate as other states like Ceará in recent years, and as it had done in the years of its earlier industrialization.

Certain aspects of the recruitment of outside firms by Ceará itself, it should be noted, seem to be more like the earlier period of the U.S. Southern states, when they had no interest in the possibilities for upgrading "traditional" industries. The optimism of Ceará and other Northeast states about competing in the export economy on the basis of the state's cheap labor, in addition, may turn out to be unrealistic–as some argue--given the massive entry into the global market by China and South Asia in the same products for which Ceará is recruiting firms–footwear and garments–with labor costs a small fraction of those of Ceará.[18] Research on important "traditional" industries like footwear in developing countries, moreover, shows that significantly greater reductions in cost can be gained from reducing wastage of raw materials and improvement of inventory management than from reducing the cost of labor (Mody 199X).

Whether the very tacit experiences of the Northeast states with the recruiting of outside firms will actually lead to improvements in strategic thinking and broader developmental impacts–as opposed to a mindless hunting of one firm after another, which may ultimately harm the local economy more than it helps–is in no way guaranteed. Up to now, Ceará and the other

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administered regionally. Ceará, along with Pernambuco and Bahia, were the most aggressive states in recruiting during that period.

[18]The economist Adrian Wood has convincingly argued from careful econometric analysis, moreover, that Latin America's chance to compete in world markets on the basis of cheap (and therefore unskilled) labor has definitively passed–if it ever had such a chance–with the entry of China, and South and Southeast Asia into world markets (1994).

Northeast recruiting states have not yet engaged in the kind of critical learning process about the recruitment experience exemplified by that of some of the U.S. Southern states described above, as evidenced by the lack of monitoring and analysis of the impact of firms recruited so far. A 1999 study of firms recruited to Ceará during the 1991-1994 period, for example, finds that only 25% of the firms recruited by the state in the 1991-1994 period are actually functioning, with direct and indirect employment created being only 22% of those reported at recruitment.[19] Overall, nevertheless, Ceará has the reputation for being successful in recruiting outside firms, and has indeed been intelligently strategic in some aspects of its recruitment activities.

Regardless of what a comparative analysis of actual jobs created and output increases across the Northeast states might tell us, other Northeast states are looking to Ceará as a model of recruitment success. It would seem important that the other states not simply imitate what Ceará is doing, without first understanding what worked and what did not, and the Bank of the Northeast has the position to help bring this about. Without this kind of understanding, moreover, the spread of the model–already underway–could overshadow more grounded efforts at achieving broad developmental impacts. The Paraíba experience with footwear, for example, exemplifies a quite different approach than Ceará's, as chronicled by Pinhanez (1998), and with different lessons.

Producing roughly half the total output of Ceará's economy, Paraíba's footwear production is roughly the same as that of Ceará. Though the Ceará recruitment success in

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[19]Vasconcelos *et al.* (1999:40). The number of firms reported to be recruited by the state in the 1991-1994 period that are actually functioning are 98 out of 446, total employment is 102,000 as compared to 469,000 projected, direct employment is 20,000 as opposed to 93,000 projected, and total investment is R$1,004.4 million as compared to R$5.2 billion projected. (Some of this discrepancy could be due to slower development of the projects of the recruited firms, but data are not available to make such an assessment.)

footwear is widely noted throughout the Northeast, one hears little about the Paraíba story–perhaps because it is based much more on a long story of local firms and institutions intertwined with a few large firms recruited from the outside. The Paraíba footwear sector stands out, moreover, as having *not* been devastated by the recent loss of three footwear firms recruited in a previous period–Azaléia, Brochier, and a plant of Alpargatas. The different style of the Paraíba development, then, needs to be as much in the minds of those looking for recruitment models as is Ceará's. At this moment, however, the Northeast has neither an assessment of the Ceará experience itself–what worked well and what did not–nor a comparative assessment of cross-state experiences.

D. The outside presence

In three cases we reviewed where Northeast states succeeded in attracting outside firms that had developmental impacts in the state, it would seem that a certain kind of aggressive lobbying by state governments traveling outside the state was more important than the recruitment subsidies themselves. This outside lobbying, to be successful, seemed particularly demanding of state capacity.[20] It required that government officials and technicians be able to present a detailed picture of that part of the state's economy relevant to a particular outsider firm, and how it would relate to the firm's need–in contrast to the more "generic" selling of the advantages of the Northeast, like sun and cheap labor. The outside lobbying process also educated the state about outside markets, and helped them develop important networks outside that would ultimately serve a state well in its strategic thinking about development in general, and in supporting *local* producers through promotion of their products through trade fairs outside the state and the country. With respect to the trade fairs and other outside promotion of local firms in particular, Dohnert (1998) points to the importance of this kind of support, and documents the pioneering role played by the Ceará state government in a much earlier period--the 1970s--in promoting the state's garment producers. The three examples presented below actually took place long before the current era of the *Guerras Fiscais*. I present them because they are so similar in certain ways to what states like Ceará are today doing, despite the fact that the current era is considered so different in many ways than the previous one. Each of these

[20]Doeringer and Terkla's studies of factors influencing recruitment and local growth, emphasize this same kind of capacity. In a region they studied within the state of Massachusetts, the central element in bringing outside firms to this region rather than others was the ability of local government "to analyze the match between the company-specific needs and the invisible strengths of the region" (1990:501). They also noted that whereas many firms could

particular cases of aggressive outside promotion left in its wake, roughly 30 years later, rooted local development in the targeted sector, or radiating out from it. None of the sectors in these particular locations has suffered from the departure of firms recruited earlier.

In the 1960s, Bahia opened offices in Rio, São Paulo, and even Paris, which aggressively promoted tourism in that state, as well as the recruitment of tourism-related companies (JT86). Today, needless to say, Bahia is the one of the most successful tourist destinations in Brazil, and the tourist sector has broad direct and indirect employment effects. Also in the 1960s and 1970s, the regional development agency for the São Francisco River Valley, CODEVASF, opened an office in São Paulo and aggressively recruited southern Brazilian firms to lease (with the option to subsequently buy) plots of roughly 200 hectares newly provided with public irrigation (Damiani 1999). As a result of this and other public actions in the region of Petrolina-Juazeiro (PJ), straddling the border of the states of Pernambuco and Bahia, this region became the only highly diversified agricultural growth pole in the semi-arid *sertão* of the Northeast that was induced by development policy. As testimony to this, PJ also became one of the first areas of the Northeast to start experiencing net in-migration, rather than legendary out-migration of the Northeast to the South. The PJ region is now an export success story, exporting grapes and mangos to Europe, and has surpassed São Paulo and some other southern states in the production or export of these and some other fruit crops.

During the late 1970s and early 1980s, finally, the governor of Ceará–Virgílio Távora–conducted a highly successful campaign in southern Brazil to "sell" the state's image as Brazil's "second" garment pole to southern consumers, wholesale and retail buyers, and outside firms in

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themselves evaluate the "visible cost factors" in the locations they were considering, they often did not have the

the garment supply chain, particularly textiles.[21]

One common pattern in these cases is not always present in the *Guerras Fiscais* of today. All of them sought to "sell" their states (or regions) on the grounds of economic activity or strong public institutions already existing in the state and particular to it: the unique cultural and architectural heritage of Bahia; "the garment tradition" of Ceará, with its collection of small and medium firms concentrated in Fortaleza; the public irrigation infrastructure and strong coordinated support of public institutions in agricultural research and river-valley development. Correspondingly, these recruitment efforts focused on particular sectors and well-defined project agendas, which would link up to existing economic activity in that state. This is different from some of the current recruitment efforts, which sometimes focus on *generic* qualities–like sun and cheap labor–that many other Northeast states, and indeed countries, also have.

Even when a state does have existing economic activity relevant to an outside recruited firm, the state government often dismisses it as backward and irrelevant, rather than building on it. Ceará's bypassing of existing artisanal shoe production in Sobral is an example, with its project to train unemployed workers in that region without experience, and to form them into associations to do piecework for larger firms.[22] Pernambuco's exclusion of its thriving garment-producing cluster centered in Santa Cruz de Capibiribe–as documented by Dohnert (1999)–from its recent program of sector-specific growth poles in the state is another example.

In themselves, then, the *Guerras Fiscais* might be viewed as neither inherently good nor

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capacity to perform an adequate analysis of the "invisible" strengths of competing potential localities (1990:501).

[21]Dohnert 1998:46ff. This was an even greater feat of salesmanship, considering that–according to Dohnert's review of the data–Ceará never ranked higher than fourth largest in garment production.

bad for local economic development. After all, the above examples all represent a certain variation on the *Guerras Fiscais* of today, with their large subsidies to the recruited firms, though with more federal and regional subsidies in relation to state subsidies than today. Yet nobody now criticizes Bahia for how it developed its tourism success; or Ceará for how it made the state an important garment pole in Brazil; or Petrolina-Juazeiro for successfully luring to the region a set of commercial firms that are the basis for the region's current success in the export of fruit abroad.

Recruitment policies are at their worst, in turn, when they cast their net widely in terms of the kinds of firms they want to attract; when they do not focus strategically on firms that would create some synergy with existing economic activity and help to make those connections happen; when they sell themselves to the outside on the grounds of generic qualities possessed by other states in the Northeast (let alone other countries); and when they do not negotiate conditions with the recruited firms that help build on what already exists in the local economy, and spreads their benefits more widely. These worst-scenario recruitment efforts can be characterized as passive– "come one, come all"--compared to the more highly strategic, focused, and demanding role of state governments in more successful and sustained efforts.

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[22]This is reported on in Amorim (199X), and Tendler and Amorim (1996).

III - Bargaining power unperceived

Any attempt to make recruitment policies work better for Northeast development must deal with the fear of state governments that they will scare interested outside firms away if they make any demands on them. This is an important barrier to turning these policies to better effect, and to preventing governments from excessively subsidizing firms that would locate in the Northeast anyway. This section discusses the perceptions that drive this fear, and reflects on their accuracy.

One of the important reasons for the perception of state governments that they do not dare ask outside firms for some *quid-pro-quos* has to do with information. Partly because of the confidentiality and the competitiveness surrounding the recruitment deals, state governments do not know about other cases in which concessions were successfully sought from recruited firms. They do not know how hard they can push and where, without scaring the potential candidate away. On the one hand, government research agencies, international donor organizations, and universities have not helped to fill this gap, since so much of their recent focus has been on the importance of recruiting such firms at any cost, because of belief in their transformative effect on local economies. On the other hand, critical commentators on recruitment policies draw attention mainly to the *ill* effects of having such outsiders on the scene. These one-sided observations have left an important gap in our basic empirical knowledge about the kinds of matters that could and should be negotiated with recruited firms. Some of these are rather simple, and may represent little trouble to the recruited firm–especially given the concern of large firms in particular for maintaining a good image in the community where they produce and in the consumer market for their product.

This section tries to throw more light on the subject by presenting and discussing some examples of bargaining power that state governments hold in their negotiations with outside firms. The first subsection treats the issue of the lure to outside firms of the Northeast consumer market, and provides a few examples. The second subsection provides some examples of states successfully making demands on the firms they recruit, and in a way that furthers the developmental impacts of the investment.

A. Missing the local market?

State governments and other public bodies in the Northeast typically promote the region to outside firms on the grounds of its comparative advantage in *production* and other supply-side factors–such as cheap and docile labor; closer access to European, and North American and other NAFTA ports; and, in the case of high-value export agriculture (irrigated fruits and vegetables), more days of uninterrupted sun than the south and a dry climate that keeps pests and plant diseases to a minimum. Correspondingly, the recruitment subsidies offered by the states are also targeted on supply-side matters–namely, lowering the cost of production (with cheaper credit, raw materials, and labor), providing infrastructure (buildings, road access, hookups to utilities), and facilitating access to labor markets (training, measures to flexibilize labor contracts such as labor cooperatives).

Implicit in these sales pitches is the seemingly reasonable assumption that it is the supply-side factors–particularly cost reduction–that make a particular state desirable for investment. At least if not more important, however, many outside firms moving to the Northeast today are also drawn by its large *consumer* market of 46 million people. This suggests that Northeast states may have more bargaining power, *vis-a-vis* firms they are courting, than is assumed.

Our interviews with firm owners and managers often pointed to the Northeast's consumer market as influencing their decisions to re-locate there. They sometimes conveyed that they wanted to secure a "beachhead" for their product in the Northeast consumer market before their competitors did. Even if Northeast poverty and illiteracy were still high, they nevertheless wanted to be well situated in the Northeast--if only for a time in the near future when that market *would* pick up. In addition, they did not want to lose out on the surplus profits to be had from being among the first to locate in that new market. Importantly, they also felt that opening up sales outlets in the Northeast would not be sufficient to create the strong presence necessary to capture this new market, and that only a new *production* facility would serve that end.[23] Such demand-side considerations were also a major factor in the decisions of many U.S. Northern firms to re-locate to or open branch plants in the South--despite the focus of state governments

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[23]I encountered these same views among large Johannesburg firms in South Africa around the time that Nelson Mandela was elected president. These firms worried that as soon as apartheid regulations were dismantled, and the new government invested in housing and other aspects of urban development in the black townships and squatter settlements, consumer demand would increase markedly, and they would miss out on this new market if they had not already established a presence in the townships. (This worry was exacerbated by their concern that black-owned firms, not yet significant producers in this market, would emerge and be preferred by black consumers; they also worried that they, the "white" firms, would be subject to consumer boycotts of white firms–a not uncommon form of civic protest during that period.)

One large window-producing company, accounting for 80% of South Africa's market, decided that opening up sales outlets for its windows in the black townships would be insufficient for establishing a "beachhead" there–similar to the views of the manufacturing firms now locating in the Brazilian Northeast out of interest in its consumer market. Since it would not have been practical for the firm to set up production facilities in the black townships–production was centralized in one plant--the company embarked on a new de-centralized form of production whereby it continued to manufacture the basic parts of the window at its central plant, packaged them in kits, and then trained and franchised myriad "assemblers" of the kits from among black welders who lived in the townships (Tendler 1994).

there, like those of the Northeast, on supply-side factors in their recruitment.[24]

The appeal to outside manufacturing firms of the Northeast market, it would seem, might work only at the level of the region, rather than any particular state–hence the collective-action problem of each state subsidizing a re-location to the region by firms that wanted to locate in the region anyway. A 1997 survey of firms recruited to Pernambuco, however, found that the size of the *Northeast* consumer market was an important factor influencing their location in that state. This same consideration–"the regional market"–also ranked among the top five factors (out of a possible ten) influencing the location of firms newly recruited to Ceará, though not as highly as in Pernambuco.[25] Despite the Northeast's locational advantage *vis-a-vis* European and North American markets, moreover, the Ceará survey found that only two among 25 firms surveyed mentioned proximity to European, NAFTA, or non-Northeast Brazilian markets as a factor in their decisions.[26]

The authors of the 1997 Pernambuco survey commented on the interest of outside firms

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[24]This was particularly the case during the 1950s after World War II–because of the increased purchasing power of consumers in the U.S. South, fueled by the location of many military bases there during the war (as lobbied for intensely by Southern in the legislators in the U.S. Senate and Congress) (GG 19XX:61). In fact, the growing consumer market in the U.S. South has been pointed to more generally as one of the factors that turned around the record on Southern growth from bad to good, coinciding with the period after the 1960s when the many decades of chronic net out-migration (similar to that of the Brazilian Northeast) turned to one of net in-migration (GG 19XX).

[25]For Pernambuco, see Vasconcelos et al (1999:16); for Ceará, Vasconcelos (1999:38-39). For Ceará, among the top five out of ten possible factors for re-location, the regional market ranked first (60%) among service firms, government incentives and economic infrastructure ranked second (60%), and labor costs third (20%). Among manufacturing firms, the regional market ranked fifth (20%)–though still higher than five other factors–with labor costs second (27%), government incentives first (40%), economic infrastructure third (27%), and perspectives of continuity in public administration fourth (27%).

[26]P. 40. It should be noted, however, that all the surveyed firms, though from outside the Northeast and including some very large enterprises, were Brazilian. With respect to foreign firms, there is also evidence of the appeal of the Brazilian consumer market. In a sample of 27 top multinational firms located in Brazil, 67% (18) were

in the Northeast consumer market as “a new fact,” given that firms previously locating in the Northeast had always looked toward markets in Brazil that were outside the region.[27] They attributed this shift in interest to the increase in real wages for the Brazilian poor, and hence consumer spending, that resulted from the ending of hyperinflation in the mid-1990s after the introduction of the new currency, the Real.

At a time when at least some outside manufacturing firms were viewing the Northeast as such an appealing consumer market, then, Northeast recruitment initiatives were focused on other supply-side matters. If the focused on consumer markets at all, however, it was to point out the desirable location of the Northeast *vis-à-vis* consumer markets *outside* the country (or in southern Brazil)–and particularly the upscale markets of Europe and North America.

Demand pulls and pushes. The fact that the Northeast was growing better relative to Southern Brazil in the 1990s, albeit slowly in absolute terms, may also have contributed to the market-driven calculus of outside firms. The “push” of the stagnant (and higher-income) Brazilian Southern consumer market would have complemented the “pull” of the growing Northeast consumer market, combined with the cost-reduction pressures of globalization. The greater income levels already achieved in Brazil’s South might work in the same direction, to the extent that southern consumer markets were becoming saturated, at least for consumer durables. A region coming out of poverty, like the Northeast, would promise more fertile ground.

Cobb’s study of the recruitment of outside firms by the U.S. Southern states found a

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interested in the internal (or MERCOSUL) market–as opposed to those interested in global markets, regionalizing Brazilian subsidiaries, or exploiting natural resources (Laplane & Sarti 1997:167).

similar push-pull dynamic operating between the more and the less developed region. He also points to the importance of the U.S. South's consumer market in driving the decisions of many Northern firms to re-locate. He suggests that a disparity in growth rates between the richer region and the poorer, moreover, explains the ebbs and flows of the moves of firms to the South through time. Such demand-side pushes and pulls, then, may have had at least as much force in the exodus of firms from the Brazilian South to the Northeast as the recruitment subsidies and other supply-side factors.[28]

To the extent that the Northeast *Guerras Fiscais* have been successful in the 1990s, then, this may be partly due to the inter-regional growth differentials of the late 1980s and 1990s–namely, the greater toll taken by trade liberalization and monetary reforms on the regional economy of the Brazilian *South*, as compared to the Northeast. By the same token, any rebounding of the Brazilian Southern economy–as perhaps has already started–could also lead to a slowdown of the rate of re-location to the Northeast, as well as a return of some firms to the South–an explanation that would be consistent with the recent return of the large shoe firm Azaléia from Paraíba to its original home in the Sinos Valley of Rio Grande do Norte.

The role of the ups and downs of the economy in the firm-*sending* region within a country merits some attention because of the exclusive preoccupation of Northeast recruitment efforts with supply-side factors and the region's appeal for the *export* market. The critics of

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[27]Vergolino & Vasconcelos (1997), as cited by Vasconcelos (1999:16).

[28]Cobb noted that when times were good and consumer expenditure high, Northern firms tended be less interested in moving to the South–such as occurred during World War II–and particularly when firms could pass cost increases on to consumers. But when industry was subject to more competition and other sources of cost pressures, firms would pay more attention to cost factors at the margin, and hence be more disposed to re-locate or open branch plants in lower-cost locations (1993:39, and 1982:24).

recruitment incentives may have also missed this same point, in that their attention also focuses exclusively on supply-side issues. They typically warn of the fickleness of firms, as partly driven by shifts in the availability of lower-cost production sites in other countries–at least in the low-barrier sectors such as footwear and garments. I am suggesting, in addition, a cause of fickleness on the demand side–namely, the ebb and flow of firms in response to changes in demand conditions in the sending region relative to the receiving region. This additional reason for instability in firm re-locations, in turn, sounds an additional cautionary note about the long-term benefits of a local economic development policy that relies so heavily on recruitment of outside firms–at least when they are, like many of the firms recruited to the Northeast, in footloose sectors.

Northeast products for Northeast markets. The seeming neglect of Northeast recruitment programs of the appeal of their own consumer market is also reflected in public initiatives to support *local* producers. The documents of Northeast public agencies, and conversations about local economic development with various officials and technicians, tend to focus on supporting firms and sectors with the potential to supply consumer markets *outside* the Northeast or the country, often upscale markets. They reflect a certain disinterest, and sometimes even disdain, for the possibilities of the closer regional market. These attitudes are partly driven, of course, by the strong focus of the federal government--and the current development discourse in general–on the importance of producing for the export market in today's trade-liberalized world. The complementary focus on the higher-quality upscale market of these injunctions is viewed as a way out of the cost pressures of global competition. Some of the cases of firm or sector growth we encountered, however, were built on the manufacture and widespread marketing of products in the Northeast, often of *downscale* products, and sometimes with an explicit strategy to occupy a downscale "niche." Examples are the "popular" garment cluster in Santa Cruz de Capibiribe (Dohnert 1998), the dune-buggy kits in Ceará (Amorim 199X), the nationally successful domestic appliance firm, Esmaltec, which got its start by producing a rustic stove affordable to poverty-stricken Northeast consumers who were still cooking only with charcoal (Amorim 199Y). The Northeast, in sum, may not only be ignoring the opportunities of the up-and-coming consumer market in its own backyard. It may also be disregarding some of the lessons of its own manufacturing successes.

Once the lure of the Northeast consumer market to outside firms is recognized, one of the most obvious ways for the region to increase its appeal to outside firms as a production gateway into its consumer market would seem to be to increase the purchasing power of Northeast consumers by reducing poverty, increasing employment, and improving living conditions (including access to communications), literacy, and health. At first glance, of course, the suggestion seems off the mark. Policymakers, politicians, and scholars have recommended such measures for decades, and for reasons much more important than that of enticing outside firms to locate in the Northeast. Many serious initiatives have been put in place that seek to reduce Northeast poverty.

At the same time, the suggestion serves to highlight a certain problem that is inherent in the region's recruitment policies. Namely, the Northeast states' desire to maintain their cheap-labor advantage as a major selling point for attracting outside firms does not augur well for increasing the widespread availability of good public education and upskilling the labor force.

This is because improvements in basic education, income, and other quality-of-life indicators for which the Northeast lags behind the rest of Brazil tend to, unfortunately, *reduce* cheap-labor advantages. Again, the U.S. South provides an example. As a respected Southern commentator has noted, the "cheap labor policy" of the U.S. Southern states has translated into a "low level of education" of the South's population, which has in turn "left the region unprepared for the current demands of the international economy for skilled labor and a literate labor force" (White 1992).

Wanting approval. So far, this section has suggested that the supply-side incentives of the recruitment packages may be less crucial than they are perceived to be, given the demand-side lure of the Northeast consumer market to outside firms. This also means that states may have more bargaining power than they think in such negotiations, and that making certain demands or requesting certain *quid-pro-quos* might not necessarily scare firms away. This subsection illustrates the point with a few examples from retail marketing by two large chains (the first also manufactures the products it markets). The examples are not as numerous, apt, or detailed as I would have liked, because I did not perceive the importance of this problem until late in the research. They are sufficient, however, to illustrate the importance of conducting further research on negotiations between governments and outside firms, a task for which the Bank of the Northeast would be well suited. The section following this one provides examples involving manufacturing firms.

Ceará and Parmalat. Conversations with some of the parties to the discussions between

Ceará and the dairy firm, Parmalat, contributed to the first of two examples. Parmalat–an Italian multinational with US$6 billion of worldwide sales, of which South America accounts for 38%–was entering the Northeast market both to sell its long-life milk (UVH in a carton) and to produce fresh milk for sale locally.[29] For different reasons, both sets of parties to these negotiations were interested in "cultivating" existing local milk producers, and the local economies dependent on that activity. The state government, obviously, worried about the fate of an important set of constituents in the rural economy, and the surrounding macroeconomics that were dependent on this activity. Hence Ceará's request that Parmalat forge, with state support, some supplier relationships with these local producers, including technical assistance for upgrading the quality of their production. Parmalat, in turn, wanted to project a benevolent image with consumers of the region–not uncommon among companies with a large presence in the economy of a region–and to have smooth relations with government in the states where it worked.

Porto Alegre and Carrefour. The second example involves municipal rather than state government, and a French multinational chain of *hipermercados* with locations throughout Brazil, including the Northeast–Carrefour. Carrefour plans to build a *hipermercado* in the city's northern zone–similar to those already functioning in several other Brazilian cities, including the

[29]These data on Parmalat are from Pérez-Aleman (2000), who describes an interesting variation on this story of Parmalat in Nicaragua.

Northeast.[30] These large stores include not only the range of foods and other goods found in a typical U.S. supermarket, but garments, footwear, household appliances, and food concessions.

Over the last year or so, the municipal government of Porto Alegre in Rio Grande do Sul has institutionalized a process for evaluating the social, economic, and environmental impacts of such proposed retail developments like shopping malls and *hipermercados* that occupy more than 2000 square meters, based on a 1998 federal decree requiring an impact analysis of all such projects (Decreto 11978 of 5 August 1998). Concerned about the socio-economic impact on the city's economy of these large establishments, and the potential market-destroying effects on business in the surrounding communities, the municipal government researched the experience of other countries in regulating such projects, especially the French case, and in linking them to the local economy. It established a Large-Project Committee (*Comitê dos Grandes Empreendimentos*) to analyze the Carrefour case and others like it.

With respect to Carrefour in particular, the analysis projected that for every job created by the new establishment, six jobs would be destroyed within a radius of 1,000 meters. Most of this job destruction would result from the inability of small retail establishments in the neighborhood to compete with such a large and discounted establishment. The corresponding net reduction of income was estimated at R$1.8 million per year. The committee also noted that Carrefour typically included several small shops in the market, which Carrefour itself managed–

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[30]I thank Professor Jacob Lima for bringing this example to my attention, and Zander Navarro and Eduardo Raupp of the Porto Alegre municipal government for going out of their way to provide me with the details. The material in this and the following paragraphs on Porto Alegre is drawn from Navarro's e-mails to me (25 and 31 August, and 1 September 2000), based partly on his discussions with Eduardo Raupp, and accompanying documents from the municipal government–Decreto Municipal No. 11.978 of 15 May 1998, a short document by the Secretaria Municipal da Produção, Indústria e Comércio [n.d.] describing the municipality's approach to large development

in the proposed project, 20. The committee also found, in analyzing employment data for that section of the city, that unemployment in the north section of the city was greatest in the 30-50-year age group.

On the basis of this analysis, and out of concern for linking Carrefour as a large and sophisticated customer to local suppliers, the municipal government requested, among other things, that Carrefour (1) increase the number of small shops from 20 to 40, and that the additional 20 be allocated with priority to local firms; (2) commit to buy products, including agricultural produce, from surrounding rural areas, as long as they met Carrefour's well known quality standards, which would carry a special seal indicating their local origin (*Sabor Local*); (3) commit to hiring at least 50% of its employees from the northern zone in which it was to locate; (4) guarantee to hire at least 10% of its new workers in the over-30 age group.[31] Carrefour granted the requests.

The municipal government's requests, and the analysis that led to them, were the result of a process involving public meetings, considerations raised by neighborhood associations (including the request that at least 50% of new jobs created go to the surrounding population), and discussions and proposals of the Large-Project Committee. The municipal government conducted a similar process with respect to another large chain of supermarkets, Zaffari, which wanted to locate in the southern part of the city. The process, which documented higher unemployment rates and lower salaries for black residents, resulted in the request for a

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projects (*grandes empreendimentos*), and analyzing the economic impact of the proposed Carrefour *hipermercado* on the surrounding economy.

commitment that Zaffari hire at least 5% black residents among its new workers. Zaffari conceded.[32]

There are a few aspects of this story that merit comment with respect to our concern about the *Guerras Fiscais*–the fear of asking firms recruited from the outside for concessions, and the lack of knowledge about what to ask for. First, the local government had studied how governments dealt with these issues in other countries, in terms of the experience and the requisite legislation and regulations; it carefully developed and analyzed data on the local economy and the projected impacts, and presented them in meaningful tables in the Committee's reports. Second, the process of studying the project and its impact benefitted from including the firms threatened with displacement, and the neighborhood in which the project would be located. Third, these kinds of requests are not unusual by municipal governments in the industrialized countries; they are now stock-and-trade in the deals worked out between U.S. cities, for example, and developers and other large enterprises.[33] Fourth, the requests would bring local producers into a customer-supplier relationship with a large and demanding buyer, hopefully creating a mechanism for upgrading the local product, including local agriculture. This is exactly the kind

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[31]The other requests were: (1) the construction of a daycare center in the region; (2) the application of recyclable solid wastes generated by the operation of the market to municipal income-generation projects; and (3) the contribution of R$480,000 for a Program of Support to the Local Economy.

[32]The memo prepared by the Large-Projects Committee on the proposed Zaffari project contained an impressive breakdown of employment and unemployment data by gender and race, including time-series data, which showed significantly greater unemployment rates for black residents (as well as lower salaries, lower-quality jobs). This data analysis was sparked in part by concerns raised by the *movimento negro* in the city. (The document in which this material appears is, "A cota racial como medida mitigatória ao impacto sócio-econômico dos grandes empreendimentos," also provided by Eduardo Raupp via Zander Navarro.)

[33]A pioneering work on such negotiations between cities and developers with respect to the development of downtown shopping centers and tourist malls in the United States is Frieden & Sagalyn's *Downtown, Inc.* (199X). In subsequent years, a large literature has developed on this subject in the U.S.

of buyer-driven local upgrading that is said to make the presence of outside leader firms so appealing. It's just that one cannot assume, as this case suggests, that this transformative effect will take place automatically.

It is interesting to note, finally, that these negotiations, analyses, and requests were conducted by the Workers'-Party government of Porto Alegre, which has given great importance to devising a locally-rooted model of economic-development policy. At the same moment that the Carrefour negotiation and Large-Projects analyses were taking place, moreover, the new Workers-Party government at the state level had been the talk of *Guerra-Fiscal* circles, because it had abrogated a previous agreement made with Ford to locate a coveted auto-assembly plant in the state. Ford ultimately moved the project to the state of Bahia, which had wasted no time in presenting a strong offer.

It is striking that at the same time that the state "scared" Ford away, the municipal government was successfully negotiating an arrangement with another multinational–Carrefour– that brought the advantages of outside recruitment in a way that enhanced local production. Hopefully, the publicity around the Ford case will not overshadow attention to the Carrefour story and others like it. The relevant lesson for our purposes is not the fear of losing a Ford, but the development-enhancing concessions achieved from a multinational firm through a proactive, analytical, and inclusive bargaining process on the part of government. The company was not scared away.

In the cases of both Carrefour and Parmalat, the willingness of these outsider firms to make concessions to state governments was driven in great part by their interest in the local consumer market for their product. Their ability to operate smoothly in that market, in turn, did not depend solely on the standard direct appeals to the individual consumer through advertising. It was also determined by the latent power of various local institutions–government agencies, political parties and elected officials, nongovernment groups, and the media–to enhance or tarnish the good will toward a particular company and its brand name. In both these cases, that is, it was in the best interest of the negotiating companies to have a “seal of good housekeeping” from government–to enhance the image of the company (and its product) among local consumers.

This set of concerns of multinational and other large national companies has become an increasingly important feature of the current age of global marketing and brand names with the widespread consumer recognition of a Parmalat or a Carrefour. This creates bargaining power on the side of government, especially if it knows what to ask for–the subject to which I turn now.

B. What to ask for?

This section explores further the matter of what state governments can and may want to negotiate with outside firms through a set of examples that not particularly related to the issue of the consumer market. The same caveat applies to the quality of the examples, as well as the same pleas for further research.

Pernambuco and Hering. The first example comes from Pernambuco, and involves a large garment firm–originally from the outside, but already located in the industrial district at the edge of the state's capital city, Recife.

In 1995, the knitwear firm Hering (subsequently bought by Fibrasil, then Vicunha)–which had previously located in the Paulista industrial district outside Recife–entered into discussions with the State Department of Commerce and Industry (SIC) about a proposed scheme by which it would decentralize the production of T-shirts to surrounding rural communities.[34] Hering proposed to the SIC that the state government subsidize part of the costs of setting up these rustic production facilities out of grant funds from a World-Bank-funded rural development program (Projeto Nordeste).[35] The state government saw Hering's proposal as

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[34]The material on this case is taken from Octavio Damiani's 1996 report to the Government of Brazil/World Bank High Commission, in a section entitled "Promoting linkages between poor producers and larger firms in dynamic activities, and government agencies mediating in contract negotiations." I also am grateful to Damiani for clarifying some factual questions about this case in an e-mail exchange.

[35] Though this particular case involved a firm already located in the state, the states of Ceará and Maranhão did resort to these subsidies from similar World-Bank-funded programs funds to recruit an outside garment firm. In these cases, the firm–Yamacom and its subsidiary Kaolin–was a Brazilian-Taiwanese producer of, originally, sewing machines. In Ceará, this experience was the first supported by the state to promote the use of newly-formed labor cooperatives in a more decentralized form of production. The firm's operations in Ceará and Maranhão eventually went under, for unrelated reasons.

appealing because it would create jobs for women in the depressed sugar-cane areas of the firm's hinterlands. Also, the firm offered to provide sewing machines, cloth, and training (during which time it paid a small training "wage"). Unusually for such arrangements, moreover, it did not insist that these "labor cooperatives"–as the newly formed groups of workers were called–sell only to Hering.

Hering was important to the state as a large employer in the garment sector (roughly 2000 workers)–the only garment producer in Recife's industrial district. The proposed scheme was also of value, in that it would reduce a chronic and politically problematic problem of unemployment in the sugar-growing hinterlands of Recife. Funding was not a problem–given the aforementioned financial and other contributions by Hering to the proposed scheme, and the easy availability of a large fund of public grant funding. This was a situation, in other words, in which one would not image that the state would even want a concession from the Hering, let alone dare ask for it. But it did. SIC had calculated the monthly wage equivalent of the piece rate to be paid the new workers by Hering, and found that it fell below the minimum wage–not unusual for paid work for women in these depressed communities, whether in agriculture or elsewhere. Based on this calculation, it reported to Hering that the state government could not support a project that yielded a wage that was less than the minimum, and requested that the firm raise the piece rate to a level that was at least equivalent (at that time, US$95 a month). Hering conceded, and the project went forward.

Though there are other important details to this story, and many criticisms have been made of this particular form of government-assisted decentralization of production to labor cooperatives, they are not central to the point being made here. Namely, the state government required a significant concession from the firm in exchange for its rather modest support to the firm's expansion.

CODEVASF and Petrolina-Juazeiro. The second example from the Northeast is somewhat far afield in time from those of today's *Guerras Fiscais*, but it provides an apt contrast of the past to the present. In analyzing the success story of the diversified agricultural growth pole in Petrolina-Juazeiro (PJ), Damiani (1999) describes the recruitment by CODEVASF (the São Francisco River Valley parastatal) of commercial firms from São Paulo and elsewhere (including the Northeast itself) to lease and later buy lots for the cultivation of fruits and vegetables, some eventually for export. The dynamism of the PJ region today is driven by many of these grower firms, and their export association, VALEXPORT–originally set up and shepherded through its early years by CODEVASF–all richly chronicled by Damiani (1999) in his dissertation on the subject. The relations of CODEVASF with the grower firms in that earlier period were quite different than those between the Northeast state governments today and the firms they are trying to recruit.

CODEVASF auctioned off its plots to the bidder with the most serious proposal for commercial agriculture. This meant that firms actually competed with each other–as Damiani emphasizes–to qualify for the recruitment subsidies. This contrasts with the opposite picture today of *governments* competing with each other to capture the favor of outside firms. Subsequently, moreover, CODEVASF "disciplined" the firms–to use Damiani's term, drawing on Amsden's analysis of South Korean industrial policy–if they did not perform in accordance with the program's larger vision of modernizing agricultural development.[36]

The PJ case, of course, is not truly comparable to the state recruitment programs of today, in that government coordination and control was much greater than in today's *Guerras Fiscais*, though it is not clear whether the PJ subsidies to individual firms were any greater than the cumulation of subsidies ceded to re-locating firms by state governments in today's GFs. The example still presents a striking picture of the extent to which firms will *not* be scared off when subject to conditions for subsidies and when, central to the point, they are *already* attracted to a region for other reasons. Indeed, the PJ case shows how firms will even compete for the "privilege" of obtaining the subsidies. This is a far cry from the way state officials speak today, as if any condition–including those much less draconian than the ones required by CODEVASF–will scare off a potential candidate.

Minas Gerais and FIAT. A more recent example from the 1990s, though with the same long history, relates to the support by the economic-development agencies of Minas Gerais to two agglomerations of autoparts firms. One, older, is in the Betim-Contagem area around the Fiat plant near Belo Horizonte, recruited by the state in the 1970s; the other is in the southern part of the state, serving the ABC region in São Paulo and, more recently, a Mercedes-Benz plant recruited by the state to locate there. The points relevant to the discussion here are part of a much larger rich and complicated story of sustained state-government support to the development of local industry together with aggressiveness in the recruitment of outside firms.

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[36]Two aspects of the program allowed this performance monitoring, and sanctions or threat of them: (1) the point at which the firm applied to buy the lot, which it could do only after some years of production under the lease; and (2) the threat to cut off irrigation water for firms that were not complying.

The story suffers considerably from the abbreviating process here, a recent account of which can be found in the work of Montero.[37]

In the early 1990s, the state government decided that the Betim-Contagem auto-cluster around the Fiat plant was, in a sense, “too” successful, with problems of congestion and pollution. The state wanted to also support an incipient autoparts agglomeration in the southern part of the state and, to that end, successfully Mercedes-Benz to locate a plant there. Fiat was in the process of adopting a Just-In-Time relationship to its parts suppliers and, with state support, had been working with the Betim-Contagem parts firms to upgrade and select a set of first-tier suppliers. The new Mercedes plant, and the support of state government to the development of autoparts suppliers there, would obviously create a substantial source of competition for Fiat in the parts market, which previously had had no major competitor in developing relationships with the nearby autoparts firms. Not surprisingly, Fiat was not happy about the state’s new initiative in southern Minas.

Risking the ire of a major outside firm like Fiat, as Minas did, is exactly the kind of situation that governments fear and, hence, go out of their way to avoid. The state’s economic development institutions, nonetheless, worked resolutely with Fiat in support of continued upgrading of the autoparts cluster in Betim-Contagem and the infrastructure serving it. At the same time, they did not swerve from their broader developmental strategy of recruiting a major competitor of Fiat in the autoparts market into the state, nor from supporting the agglomeration of parts firm forming around the new Mercedes plant in the southern part of the state. “Far from

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[37]The material on the Minas case in this and the following paragraph is taken from Montero’s excellent study (2000 forthcoming, and an e-mailed abstract of that paper of 8 June 1999). I thank Montero for generously providing me with some additional explanations and details by e-mail (20 August 2000) and in a conversation thereafter.

kow-towing" to the large multinational firms recruited to the state, Montero concludes, the state government "subtly opposed some of these firms' interests while at the same time serving them."

North Carolina and BMW. Another example, also involving automobile production, comes from the U.S. South. As recounted by Lowe in her paper for the BN project (1999:44), the German auto firm BMW chose the state of North Carolina in the early 1990s to locate a new auto-assembly plant, after a much-contested competition for the firm's attention by various U.S. Southern states. As part of the negotiation, local agencies in the city of Spartenburg where the plant was to be located asked that BMW "de-automate" a particular production process in the new plant that had not been previously automated. The state had wanted the new plant to tap into a pool of existing skilled welders in the region, which would not happen of that particular production process were automated. BMW conceded.[38]

Charlotte and its unemployed. Another example also involves the U.S. state of North Carolina, and this time the city of Charlotte. It has parallels with the Carrefour story told above, though it relates to manufacturing rather than large multinational retail buyers. In the mid-1980s, the mayor of Charlotte, who became nationally known for the quality of his administration, noticed that the heavy manufacturing firms clustered in the southwest end of the city were recruiting their labor force from a rural area on the other side of the nearby state border with

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[38]Some U.S. Southern states, in an earlier period, actually required that a firm guarantee a certain dollar level of employment for a certain number of years (Cobb 1982:16ff).

South Carolina.[39] Several of the firms had received recruitment subsidies from the state previously. The mayor noticed that none of these jobs were going to residents of the inner city of Charlotte, where unemployment was extremely high. He had a good working relationship with the industry associations of the city, and asked them why.

The firms were hiring outside the state, they said, for two reasons. First, there was no public transport between the inner city and these particular industrial plants. Second, these workers would require "job-readiness" training. The city offered to provide public transport to all employees living in the inner city and working in the Southwest area, as well as job-readiness training–mainly, in preparation for the job interview–and the firms started to interview and hire from that area for the first time. Many inner-city workers obtained jobs, and for salaries substantially higher than the minimum wage (albeit in difficult industrial work).

In telling the story, the mayor stressed the informality of the arrangements–no red tape, no formalities, one city worker who monitored the arrangement. Though the transport program was suspended some years later, this seemed to be partly because of its very success. Now that the path to these jobs and this part of the city had been opened to inner-city workers, many of them had found their own means of transport, making special public bus transport for this purpose no longer necessary.

The seeming ease with which a problem like this was solved, plus the informality and simplicity of the solution, are striking. Also important was the , ongoing interaction that the mayor had established with business associations, which set the stage for working on problems

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[39]As told to me by the mayor, Harvey Gantt, to whom I am grateful for helping me to get the details of the story straight after writing a first draft.

as they came up, and in a climate of comity rather than confrontation. That the solution to the problem and the city's involvement turned out to be only temporarily necessary is also interesting: the need was for breaking a logjam, rather than creating an ongoing program. Once the logjam was broken, the current of job-seekers and workers could flow on its own back and forth between the firm. This is the nature of at least some of the requests that local governments can make of outside firms. They must, , of course, have an idea of which actions would lead to a greater spilling of the benefits of large firms to their surrounding community, not to mention a public-sector commitment to such an agenda.

Conclusion. The problem of the Northeast's *Guerras Fiscais,* in sum, is not only that state governments are afraid to raise such questions with outside firms, and make demands of them. In addition, state governments often seem to have little sense of what they might ask for. This reflects the lack of information about which kinds of adjustments, which types of firms, and which kinds of circumstances are likely to generate desirable development impacts–and which are not. Not knowing what to ask for, in turn, is partly a result of the profound faith of today's development discourse–as heard repeatedly throughout Brazil and the world--in the transformative power of the outsider and "leader" firm." Just set it down in a poor region, the story goes, and it will work its developmental magic.

Adding to this problem of inadequate information is the closed nature of the negotiations around the recruitment process, which seems to spill over to the state's strategic planning about recruitment itself. This brings to mind the contrasting example of the Minas case, where a large number of public bodies and industry associations contributed to the planning–and the aforementioned U.S. Southern case, where local business and other entities important in the local economy contributed to the strategic thinking about recruitment in the cases where learning took place, and even to the vetting of particular firms proposed to receive recruitment subsidies. This widening of the process brought business expertise to the public side of the negotiating table, as well as informed voices about matters of local concern for business and labor.

The lapses in information about recruitment in the Northeast, and in understanding the outcomes of past recruitment efforts, must certainly contribute to the constraint of state governments in asking for concessions that recruited companies might otherwise cede willingly. It also causes them to expend scarce public resources in a way that may not be necessary. Again, the Bank of the Northeast is especially suited to help remedy these kinds of failures of information and understanding, for reasons I turn to in the conclusion.

IV - Conclusion

Given the importance attributed by Brazilian state governments to recruitment of outside firms as a tool of economic development, and the strong criticism of these policies by economists, the federal government, and others, it is striking that there is little analysis of the local economic impacts of firms recruited through the *Guerras Fiscais*. Much of the analysis has been directed, rather, to the fiscal impacts–also a matter, obviously, of clear importance. At the most basic, comparative information is needed on the number of jobs actually created–direct and indirect--and the value added, as compared to the numbers stated in the original recruitment protocols. To complicate this problem, some of the analyses on this subject start with a strong positive or negative premise about the *Guerras Fiscais*, and then set out to prove the point. This is not conducive to generating good comparative data, nor an understanding of what worked well and what did not.

Some recent studies of firms recruited to states outside the Northeast, or to other countries, also suggest the need for a better understanding of the results of recruitment policies as a basis for improving them. Some researchers have found, for example, that the number of jobs created and the linkages to the local economy resulting from firms recruited from the outside can be significantly less than those announced when the agreements are signed. Arbix's research on the auto-assembly plants located in southern Brazil is an example, in which he found that jobs and linkages to local industry were less than expected (1999, 2000). In another example, as noted earlier, a projected Carrefour *hipermercado* in Porto Alegre would, according to an analysis by the municipal government, have destroyed six jobs in a radius of 1,000 meters for every one job created.

Several researchers are starting to find, in addition, that global firms and other foreign buyers in today's globalized world increasingly expect their suppliers in countries like Brazil to purchase their equipment and inputs abroad, even if these suppliers had previously established purchasing relationships with local suppliers. This can have a strong adverse impact on local firms and, when the supply value-chain is clustered in one place, on whole regions–as in the case of the leather-goods cluster, including the metal-mechanic suppliers of equipment, in the Sinos Valley of Rio Grande do Sul (Schmitz 199X). Schmitz' study, after chronicling the increasing production of that cluster for ever-larger multinational buyers, finds that the latter prefer their suppliers to buy equipment and other inputs abroad rather than, as was these shoe firms' earlier practice, locally). This has clearly has adverse effects on the metal-mechanic and other industries in the Sinos cluster supplying footwear producers there.

Laplane & Sarti report findings suggesting a similar process of adverse impacts for several intermediate-goods industries in Brazil. They argue that the significant difference in Brazilian growth rates in the 1994-1996 period between Brazil's consumer-goods sector (high growth) and the intermediate-goods sector (low growth) is due in part to the increase in direct foreign investment in Brazil–and the fact that these firms prefer to buy their equipment and other inputs outside the country abroad rather than locally.[40] These kinds of findings, they suggest, reveal a "weakening of [the] productive and technological linkages" that are typically associated with new industry as an engine of local economic growth, and a "loss of the multiplier effects" of

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[40]Laplane & Sarti (1997:150-151). In the 1994-1996 period, consumer durables grew by 43% (as driven particularly by automobiles, electronic products, and domestic appliances), and non-durable goods grew by 9.7% (mainly foods, drinks, and cleaning products). In contrast, output in the intermediate-goods sector *declined* by 7.9% in the same period–with equipment and other capital goods suffering the most.

industrial growth (p. 151). Kaplinsky and Barnes (2000) come to a similar conclusion for the autoparts industry in South Africa, in relation to the effects of recent increases in direct investments by multinational auto firms there.[41]

These linkage-weakening aspects of global sourcing and direct foreign investment have also played themselves out as a result of privatizations of state-owned enterprises, which frequently have been important large customers for local firms, with important backward linkage effects in certain sectors. The purchase of equipment and other inputs by state enterprises in steel, aluminum, electric power, and petrochemicals, for example, has been important historically in driving the growth of the metal-mechanic industry in many regions–such as the petrochemical complex in Bahia, and the surrounding metal-mechanic agglomeration. The new private and often multinational owners of the parastatals have often followed the same linkage-weakening path, switching their procurement to outside suppliers and products better known to them. Because these parastatals had occupied sectors with strong backward-linkage effects, the procurement effects of the privatizations could be particularly serious to local economies.

In a study of the metal-mechanic cluster in the Guayana region of Venezuela, which had evolved around the steel-making parastatal SIDOR, Dohnert has found that when SIDOR was recently privatized by a multinational consortium of mainly Brazilians and Argentines, the newly

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[41]Based on their study and others they cite, they find that the share of value generated by direct foreign investments inside many developing countries is falling –given that a larger and larger percentage of the product's return is being generated outside the country, in costs associated not only with imported inputs, but other items such as transport, marketing, importer commissions, etc. They also cite an example from a study of the non-traditional agricultural exports from East Africa to England by Humphrey et al. (1999), in which production and services in-country accounted for only X% of the final price of the product. Two of our case studies involved just such exports–melons from Rio Grande do Norte (Gomes 199X) and grapes and mangos from Petrolina-Juazeiro (Damiani 1999). Cost profiles of these products prepared by Embrapa also revealed similarly low percentages of total product value generated in production and post-harvest activities and, hence, within the state.

privatized firm stopped purchases from these local suppliers and insisted instead on importing from suppliers known to them from their previous operations outside the country.[42] The new SIDOR was leery of the quality of the local product and alleged corruption in the letting of contracts between the previously public firm and its suppliers.

I report on the Venezuela story at some length because it not only illustrates a variation on the linkage-weakening problem for local economies, but it also shows how an adverse outcome may not be turned around or prevented. Because the Guayana region had developed, prior to the privatization, a strong and interwoven set of local institutions across business, labor, political parties, and regional government, the local suppliers succeeded in getting the privatized SIDOR to reconsider, and to work with the local suppliers to upgrade quality. Though the final outcome is still unfolding, the privatized SIDOR's early response to working with local suppliers was positive–it was surprised at the high quality of the product of some of the local firms with which it was working. Without the activist and strategic response of local industry and regional government to the problem of SIDOR's switch in procurement policy, this potentially happy outcome would not have been possible.

Governments and other institutional actors need to learn from such cases how to negotiate less unhappy endings–like the one that may be evolving in the Venezuelan case--and about the nature of the institutional "architecture" that makes this possible. On the one hand, moreover, the cumulative effect of such cases should be to have a sobering effect on the enthusiasm surrounding the outside leader firm as a transformative development agent. On the

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[42]This material comes from a dissertation in progress by Sylvia Dohnert. I thank her for reviewing a first draft of these paragraphs.

other hand, and returning to the subject of the *Guerras Fiscais*, the Venezuelan case suggests that such unhappy outcomes need not be foreordained. This should be the starting point for analyzing similar cases in the Northeast, with the purpose of providing the basis for a more empirically-informed set of policy recommendations.

The Bank of the Northeast would seem well-positioned to lead such a lesson-learning exercise, and help reduce the information-limiting aspects of the *Guerras Fiscais* between the states. Even if the GFs continue to be denounced as policy, the experience should nevertheless be mined for its contribution to understanding these broader matters of economic development in today's Northeast. First, as a supra-state entity, the Bank of the Northeast would not act in the interest of any particular state. Second, as a Northeast regional institution identified with the promotion of the Northeast's concerns, it can be counted on to be more sympathetic than the federal government in researching this issue. Third, the BN has a longstanding reputation in the region of sponsoring serious economic research, and of promoting important debates on the region's economic development. Fourth, the BN has a direct interest in the fate and fortune of the *Guerras Fiscais*, in that it provides a significant portion of the package of subsidies to recruited firms in the form of long-term investment credit on desirable terms not available at private banks, as well as access to working-capital credit.

The purpose of a BN-sponsored assessment of recruitment outcomes would not necessarily be to denounce the policies and prove them wrong, or berate any particular state. More specifically, it could explore the workings of cases of concessions asked by state governments that had happy endings, as in the examples above, The firm was not scared away, and the developmental impact was good. It could sponsor informational tours for state officials to places with a long history of recruitment and learning from it–like Minas Gerais or particular states in the U.S. South, where recruitment policies tended to stimulate local development. More generally, it could sponsor studies exploring the circumstances under which recruited firms do have significant impacts, also bringing to bear the findings of studies that are already available–what kinds of firms, what kinds of products, what kinds of local conditions. This needs to include the nature of the *processes* and local institutions facilitating interaction of local government with a large company–factors that may be just as important in determining a positive outcome as the content of any particular request.[43]

These assessments might also be used as a modest step toward a larger initiative that could help alleviate the collective-action problem faced by the states in the *Guerras Fiscais*. The assessments could be used as a focal point for convening technicians from the state departments of economic development–and later Department Directors and governors–to disseminate and discuss the findings, and compare experiences. This might start a process toward reducing the lack of information that fuels the tendency of individual states to offer more than they need to, and create a "safe place" for states to exchange information with each other about their experiences, rather than conceal it.[44]

BN leadership in this area, in sum, would help generate some collective Northeast-wide

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[43]Such an analysis might draw on some of the insights of Frieden & Sagalyn's book (199X) on the transition of many U.S. cities in the 1970s from a regulatory relationship with private developers to a "dealmaking" one during the 1980s. Aside from chronicling this transition, the book describes both the strengths and weaknesses of city governments in this area.

[44]In the 1940s, the Tennessee Valley Authority–as a similarly supra-state but regional authority, with responsibility for developing the river basin that included all or parts of seven U.S. Southern states–tried to play a role of moral leadership with respect to the Economic Wars. Its prominent and politically powerful leader publicly eschewed

learning with respect to what is turning out to be one of the most important instruments of industrial policy today. Although “real” industrial policy is now considered a thing of the (discredited) past, its explicit and public formulation at that time at least contributed to making it the subject of extensive examination and debate–by the federal government, universities, SUDENE. and the BN itself. The *Guerras Fiscais* suffer from the lack of this micro-research attention, except for the purpose of condemning them. To be sure, this is partly the result of the confidentiality and individual nature of the deals between the states and their recruited firms, making it difficult to gather the simple and basic information needed. In that the GFs of today are “industrial policy” only in an implicit sense, then, this–and the denunciation of them--keeps them from receiving the serious monitoring attention they deserve.

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recruitment policies that “pitted one state against the other,” and vowed to attract outside firms to the region on the basis of its comparative advantages (Lilienthal Journals, 19XX).

Annex I
Papers resulting from the MIT/BN Project (1998-2000)

Almeida, Mansueto. Market Failures and Credit to Medium Firms in Northeast Brazil. First Year Doctoral Paper.

Bianchi, Tito. The Complex Task of Surviving: Lessons for Policy-Makers from Northeast Brazilian Cooperatives.

Tito Bianchi, "APAEB's Natural Fiber," *Grassroots Development* (Journal of the Inter-American Foundation), Vol. 22 (No.1, Summer, 1999):38-45.

Tito Bianchi, "Development Discontinuities: Leaders and Intermediaries in Cooperatives of Producers," WIDER (World Institute of Development Economics Research) Working Paper No. 166, October 1999.

Damiani, Octavio. Beyond Market Failures: Irrigation, the State, and Non-traditional Agriculture in Northeast Brazil. PhD dissertation.

Dohnert, Sylvia. Collective Services, Large Firms, and Clustering: Pulling Together the Threads of Cearense and Pernambucan Garment Industries.

Gomes, Raquel. Unexpected Growth and Unintended Spillovers: The Making of the Melon Industry in Mossoro-Assu, Northeast Brazil. First Year Doctoral Paper.

Lowe, Nichola. The Foundations of 'High-Road' Policy: Rethinking the Origins of Economic Crisis and Reform in 20th-century Mississippi--Lessons for Northeast Brazil.

Natalicchio, Marcela A. Changes in work organization schemes in the textile and garment sectors in the northeast of Brazil: the case of Ceará." February 2000.

Pinhanez, Mônica. Training and Social Liaisons: Long-Lasting Industrialization in Northeast Brazil's Shoe Industry. First Year Doctoral Paper.

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[45]Entries with asterisks refer to papers produced under the MIT/BN project.

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